CASE LAW

MUTUALITY IN INCOME TAX LAW

BRITISH BROADCASTING CORPORATION v. *JOHNS*

For many years now it has been accepted that the principle of mutuality prevents certain receipts from forming taxable income in the hands of the recipient. In *British Broadcasting Corporation* v. *Johns*[1] the Court of Appeal (Willmer, Danckwerts and Diplock, L.JJ.) decided that the B.B.C. was not liable to income tax on its annual surplus of funds received from the Postmaster-General over expenditure, and the grounds of the decision, insofar as they relate to the mutuality principle, are the subject of this note. In particular, questions of some interest are raised by the Court's application to the facts in this case of a principle whose scope, formulation and ultimate basis have yet to be satisfactorily determined.

I THE FACTS

The B.B.C. was first established by Royal Charter in 1927. In 1957-58 the Charter governing its operations was one granted in 1952, and this required the B.B.C. to apply the whole of its income solely to promoting its objects: the objects were, broadly, to provide as public services sound and television broadcasting to the United Kingdom (the "home services") and to overseas countries (the "external services"). The general purposes of the B.B.C., purposes which were always adhered to, were set out in the preamble to the Charter, namely, the dissemination of information, education and entertainment to the public. The Charter provided that upon the voluntary or compulsory dissolution of the Corporation its surplus assets, after satisfaction of debts and liabilities, were to be disposed of in accordance with the directions of the Postmaster-General.

The operations of the B.B.C. were to be carried on in accordance with a non-exclusive licence obtained from the Postmaster-General, and one of the conditions expressly forbade it from receiving money for any broadcast or putting out commercial advertisements or sponsored programmes or distributing any funds as profit among its members. Thus fees levied in respect of wireless licences under the Wireless Telegraphy Act, 1949, were paid not to the B.B.C. but direct to the Postmaster-General and thence to the Exchequer. The primary source of the Corporation's funds for home services was sums voted by Parliament, paid through the Postmaster-General, and calculated as a varying percentage of the licence fees paid by the public. As the Postmaster-General collected the licence fees, the Corporation in this aspect of its affairs did not deal directly with the ultimate source of funds. These sums were arrived at after discussions every few years and ranged between 85% and 100% of the licence fees collected. The external services of the B.B.C. were financed by annual grants-in-aid subject to the control of Parliament.

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[1] 41 T.C. 471; (1965) 1 Ch. 32 (C.A.). (Where a decision is reported in the Tax Cases series, the practice will here be adopted of giving the citation both in the Tax Cases and in the Authorised Reports when the decision is first referred to, and thereafter only in the Tax Cases.)

Although the Corporation's Charter and licence placed its operations under the control of the Postmaster-General, in practice it was virtually independent as regards home services, both in its day-to-day administration (including the recruitment and appointment of staff) and in its editorial policy; overseas services, however, were subject to greater control. As activities ancillary to its main purposes, the B.B.C. issued publications, including the *Radio Times* and the *Listener*, but the profit from these publications was calculated as a separate figure independently of the Corporation's other activities. In arriving at the profit no charge was made for the use of capital or for the use of copyright material such as details of forthcoming programmes. In 1957-58 a net profit on all publications of £706,956 remained.

In making grants for home services Parliament made no distinction between capital and revenue expenditure. Consequently capital expenditure had to be provided from annual revenue, and it was the practice to budget some years ahead. The budgets formed the basis for discussion when a fresh grant was negotiated, and in some years there was a surplus of income over expenditure caused by the accumulation of funds towards anticipated expenditure. In the year in question the surplus was £655,745, and this sum, together with the £706,956 referred to earlier and £133,167 interest on the investment of surplus funds (making a total of £1,495,868), was sought to be taxed by the Crown.

II THE JUDGMENTS

The Crown contended that the whole amount fell within either Case I or Case VI of Schedule D of the Income Tax Act, 1952.[2] The B.B.C., however, argued that although there was a surplus for the year there was not a taxable profit; so far as that surplus went, it was not an "annual profit or gain" within the charge in the Schedule.[3] The surplus, it was argued, merely represented the excess of money paid by the Government to the B.B.C. over money spent, and could not be a profit or gain because it was still solely applicable to the provision of broadcasting as a public service. The Special Commissioners found in favour of the Crown, considering that what they termed the "well-known" mutuality principle was inapplicable.[4] Wilberforce, J. in the Chancery Division agreed, preferring to classify the payments made by the Government as a subsidy which the B.B.C. made its own rather than as falling within the principle of the mutual insurance or rating cases.[5] "I cannot regard the B.B.C.", His Honour said, "as year by year spending the Postmaster-General's money—as the housewife spends the housekeeping allowance—and carrying forward this money."[6]

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[2] 15 & 16 Geo. 6 and 1 Eliz. 2 c. 10. The relevant provisions read more fully:

122 The Schedule referred to in this Act as Schedule D is as follows—

Schedule D

1. Tax under this Schedule shall be charged in respect of—

(a) the annual profits or gains arising or accruing. . . .

. . . .

123(1) Tax under Schedule D shall be charged under the following Cases respectively, that is to say—

Case I—tax in respect of any trade carried on in the United Kingdom or elsewhere.

. . . .

Case VI—tax in respect of any annual profits or gains not falling under (any other Cases of Schedule D) and not charged by virtue of . . . Schedule B, Schedule C, or Schedule E.

[3] It was also argued that the B.B.C. was not liable to income tax as it represented the Crown in carrying out a public purpose and was entitled to Crown immunity, and that, if there were a taxable profit, a substantial deduction was available. The first submission failed, the second was supported by *dicta* of the majority in the Court of Appeal: these submissions are not considered in this note.

[4] 41 T.C. 471 at 481.

[5] As to these cases, and the principle supposed to be contained within them, see below. No attempt will be made at this early stage to state the "mutuality principle".

[6] 41 T.C. 471 at 491-2.

In the Court of Appeal, however, the B.B.C. was successful. Willmer, L.J. first stated that in his opinion it made no difference whether the B.B.C. was regarded as carrying on a trade or not,[7] and then, in a definite reversal of Wilberforce, J., said:

> In such circumstances if the B.B.C. is left with surplus funds in its hands at the end of any given year because it has not spent the whole of the grant made to it by the Postmaster-General, it seems to me that it has no more made a profit than has the housewife who manages to get through the week without spending the whole of her husband's weekly housekeeping allowance. The grant made to the B.B.C. is not to my mind to be regarded as being in the same category as a subsidy paid to a trading company to assist it in carrying on its trading activities, as was the case in *Smart* v. *Lincolnshire Sugar Co. Ltd.* 20 T.C. 643.[8]

Willmer, L.J. proceeded to enunciate as the rule to be drawn from the mutual insurance and rating cases that where the person ultimately entitled to the surplus is the same as the person who contributes the fund out of which the surplus is created, there can be no profit.

Diplock, L.J. agreed in the result, but his reasons are not immediately apparent. It will be later suggested that he based his conclusion on the fact that the B.B.C. was not carrying on a trade, and not on the identity between contributor and ultimate recipient.

The judgment of the third member of the Court, Danckwerts, L.J., appears to combine the reasons of his brethren. He regarded it as conclusive of the issue that the B.B.C. was not carrying on a trade, considering that no question of a profit could arise at all: this view is to be contrasted with that of Willmer, L.J. Danckwerts, L.J. asked:

> How can it be possible to trade if the body concerned is forbidden to take any money from anybody in respect of the operations concerned? And how then can it be possible to make a profit? In my opinion, the conclusion of the Commissioners must be rejected, and this really, in my opinion, is decisive. . . .[9]

It will be noted that the learned Lord Justice is here saying that the fact the B.B.C. is not (in his opinion) carrying on a trade prevents there being a profit at all: he is not (despite his later reference to "falling back on Case VI of Schedule D"[10]) merely relying on the words "in respect of any trade carried on . . ." in Case I of Schedule D.[11] As an alternative reason for there being no profits, however, the mutual insurance and rating cases are referred to and the same conclusion reached by applying the principle to be drawn from them as was reached in like manner by Willmer, L.J.[12] It is to be noted, incidentally, that both his Lordship's formulations of this principle are in their terms directed to whether there would be a profit in the hands of (in this case) the Postmaster-General on the return of the surplus.

It was conceded by the B.B.C. that insofar as the moneys it held were in truth income from investments or profits from a trade carried on with the public—such as the profit from the sale of publications—they were subject to tax. The Court of Appeal, again reversing the court below, saw no objection

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[7] *Id.* at 500.
[8] *Id.* at 501.
[9] *Id.* at 508.
[10] *Id.* at 508.
[11] *Supra* n. 2.
[12] 41 T.C. 471 at 509.
These illustrate the principle that, where moneys which represent a surplus on the operations carried out are returned to the contributors who provided them, these are not profits.
To put the matter another way, if a man provides a sum of money for the carrying out of a certain purpose which proves more than is required, and receives back the surplus, it is not a profit but a return of his money.

to severing this income from the rest of the money in the Corporation's hands, even though it would involve "a calculation of some difficulty and complexity".[13]

III PREREQUISITES OF MUTUALITY?

It was mentioned earlier in this note that *B.B.C.* v. *Johns* was of particular interest in its effect on the scope, formulation and ultimate basis of the so-called mutuality principle. Previously this principle had been applied only to relatively restricted classes of cases. It is regarded as first having been accepted in the "rating cases" where rating authorities who collect water or municipal rates have been considered as merely holding a surplus of receipts from ratepayers over expenditure for the benefit of ratepayers.[14] Then it was applied firmly in mutual insurance cases where a group of persons contributed to a common fund for insurance purposes, even when a separate corporate entity was created to act as insurer.[15] Further developments extended the principle to the income of members' clubs so that subscriptions and payments by members for services did not constitute taxable income of the club.[16] There is no reason to limit the principle to cases of the kind mentioned, and it has in fact been applied beyond them.[17] *B.B.C.* v. *Johns* indeed is significant as an endorsement of its application in any circumstances in which it can be found appropriate.

Although the mutuality principle is endorsed and applied to a new situation, this very novelty calls in question some of the requirements which had been regarded as necessary prerequisites to its application; it raises more acutely the question of the correct formulation of the mutuality principle and the relevance of each of the factors discussed below.

(1) *Separate Personality*

It was early established that despite the decision in *Salomon* v. *Salomon*,[18] the fact that operations are conducted by the society, club, municipal body or other entity through a separate legal entity distinct from the contributors to its funds was no bar to mutuality.[19] The ground for disregarding the corporate entity seemed to be that it was "the mere trustee, hand and instrument of

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[13] *Id.* at 500 *per* Willmer, L.J., referring to *Carlisle and Silloth Golf Club* v. *Smith* 6 T.C. 48 and 198, (1913) 3 K.B. 75.

[14] *Re Glasgow Corporation Waterworks* 1 T.C. 28; *I.R.C.* v. *Forth Conservancy Board (No. 2)* 16 T.C. 103, (1930) S.C. 850, (1931) A.C. 540; *Ostime* v. *Pontypridd and Rhondda Joint Water Board* 28 T.C. 261, (1944) 1 All E.R. 185, (1946) A.C. 477. *Quaere*, however, whether the principle of the rating cases is the same as the mutuality cases later discussed: see, e.g., *per* Wilberforce, J. 41 T.C. 471 at 490-1 and *infra* n. 61. S.23(d) Income Tax Assessment Act (C'wlth.) now specifically exempts the income of such authorities.

[15] *New York Life Insurance Co.* v. *Styles* 2 T.C. 460; *Jones* v. *South-West Lancashire Coal Owners Association Ltd.* 11 T.C. 790, (1927) A.C. 827; *Municipal Mutual Insurance Ltd.* v. *Hills* 16 T.C. 430; *Faulconbridge* v. *National Employer's Mutual General Insurance Association Ltd.* 33 T.C. 103; and by extension beyond insurance cases, *Revesby Credit Union Coop. Ltd.* v. *Commr. of Taxn.* (1964) 38 A.L.J.R. 358. See now s. 121 Income Tax Assessment Act (C'wlth.).

[16] *Carlisle and Silloth Golf Club* v. *Smith* 6 T.C. 48 and 198; *The Bohemians Club* v. *Act. Fed. Commr. of Taxn.* (1918) 24 C.L.R. 334; *The National Association of Local Government Officers* v. *Watkins* 18 T.C. 499; and now *Adelaide Racing Club Inc.* v. *Fed. Commr. of Taxn.* (1964) 38 A.L.J.R. 204 applying the principle where the club is incorporated. These cases clearly go beyond merely classifying subscriptions as contributions to capital; e.g., in the two cases last mentioned, dining-room receipts from members were non-taxable.

[17] E.g., the attempted application to credit unions (*Revesby Credit Union Coop. Ltd.* v. *Commr. of Taxn.* (1964) 38 A.L.J.R. 358) and to contributions by shareholder-occupiers of home units (7 C.T.B.R. (N.S.) Case 71), a matter of particular significance in relation to bodies corporate under the Conveyancing (Strata Titles) Act, 1961 (N.S.W.).

[18] (1897) A.C. 22.

[19] E.g., *New York Life Insurance Co.* v. *Styles* 2 T.C. 460; *Jones* v. *South-West Lancashire Coal Owners Association Ltd.* 11 T.C. 790; *cf.* Finlay, J. in *The National Association of Local Government Officers* v. *Watkins* 18 T.C. 499.

the (ratepayers)",[20] that it "is merely a legal entity which represents the aggregate of its members".[21] Difficult as this may be to accept, even greater difficulty may be experienced in so regarding the B.B.C., when Wilberforce, J. and the Court of Appeal, in holding that the Corporation was not entitled to Crown immunity, made it clear that they regarded the B.B.C. as more than a mere "hand and instrument" of the Crown.

(2) *Complete Identity*

The most stringent statement of this requirement is that of Lord Macmillan in *Municipal Mutual Insurance Ltd.* v. *Hills*, where it is said:

> . . . the cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between the contributors and participators.[22]

This strictness is tempered by decisions that there need not be any periodical distribution of a surplus provided that "sooner or later, in meal or in malt, the whole of the (Association's) receipts must go back to the (policy-holders) as a class, though not precisely in the proportions in which they have contributed them".[23] The identity required is a class identity, not an individual identity.[24]

But in some cases there are indications that the identity must also be between those contributing to the common fund and those benefiting from the application of the contributions. The decisions prior to *B.B.C.* v. *Johns* did not, on their facts, raise the question explicitly, but in the mutual insurance cases it is said to be necessary that the contributors associate for their mutual benefit, that the common fund be applied "for the benefit of those same people".[25] It seems to be necessary in the club cases that the members at least have the right to participate in club affairs and use the club facilities, even if they do not avail themselves of the right.[26] In the rating cases in particular it cannot be said that the contributors participate in any surplus on a winding-up—rather the surplus is carried forward to the next year to be used for the benefit of the ratepayers.[27]

The present case, however, is new; there is only one contributor. Must

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[20] *Re Glasgow Corporation Waterworks* 1 T.C. 28 at 50 *per* Lord Deas.

[21] *New York Life Insurance Co.* v. *Styles* 2 T.C. 460 at 469-70 *per* Lord Watson. Of course, it is hard to see an insurance company as the agent or "hand and instrument" of the policy-holders.

[22] 16 T.C. 430 at 448.

[23] *Jones* v. *South-West Lancashire Coal Owners Association* 11 T.C. 790 at 838 *per* Viscount Cave, L.C.

[24] *Faulconbridge* v. *National Employers' Mutual General Association Ltd.* 33 T.C. 103 at 105 *per* Upjohn, J.:

> When viewed in the light of the other cases, I think it is clear that when Lord Macmillan speaks of the cardinal requirement being complete identity between the contributors and the participators, he is not referring to individual identity but to identity as a class, so that at any given moment of time the persons who are contributing must be identical with the persons who are entitled to participate, whereas it follows in my judgment, that it matters not that the class has been diminished by persons going out of the scheme or that others may come in in their place in the future.

[25] *Jones* v. *South-West Lancashire Coal Owners Association* 11 T.C. 790 at 822-3 *per* Rowlatt, J.; see also *Municipal Mutual Insurance Ltd.* v. *Hills* 16 T.C. 430 at 438 *per* Rowlatt, J. "associating together to put up money to achieve an object for each other".

[26] *Bohemians Club* v. *Act. Fed. Commr. of Taxn.* (1918) 24 C.L.R. 334; *The National Association of Local Government Officers* v. *Watkins* 18 T.C. 499. Indeed, many clubs have a "cy-pres" clause in their constitution precluding participation by members in a winding-up—does this also preclude mutuality?

[27] See cases cited *supra* n. 14, and generally, G. S. A. Wheatcroft, 1 *British Tax Encyclopaedia* para. 417 "contribute to a common fund in pursuance of a scheme for their mutual benefit". In *I.R.C.* v. *Eccentric Club Limited* 12 T.C. 657 the surplus held by an incorporated club escaped tax because it was applied solely to the promotion of the club's objects and was not returnable to members.

the benefit of the application of the money contributed accrue solely to the Crown? If so, does it accrue sufficiently through the B.B.C. supplying services which its Charter designates as "public services" and obliges the Corporation to supply? Is the B.B.C. supplying public services although similar services can be supplied by private enterprise? Is there sufficient identity of application through the benefit accruing to a third party (the public) at the direction of the Crown? These questions are all raised.

(3) *Subsidy*

It is appropriate to mention, simply because it forms a point of difference between Wilberforce, J. and Willmer, L.J., how thin the dividing line may be between a "contribution" which is non-assessable under the principle of mutuality on the one hand, and a subsidy which is assessable to tax on the other. "Payments in the nature of a subsidy from public funds made to an undertaker to assist in carrying on the undertaker's trade or business are trading receipts."[28] A payment may be a subsidy even though, as in *Smart* v. *Lincolnshire Sugar Co. Ltd.*,[29] it must be repaid if the recipient company is wound up or put under a receivership within three years, for it is sufficient that the payments were made to the company in order that the sums might be used in its business—the sums then have a "business nature" which makes them supplementary receipts.[30]

It was clearly open to characterise the payments in *B.B.C.* v. *Johns* as a subsidy, particularly as the B.B.C. was providing a public service. Against this, of course, the B.B.C. was an authority closely linked with the Crown, the payments were a substantial part of its income, and—although Willmer, L.J. regarded this as of no relevance[31]—there was at least doubt whether the Corporation was carrying on a trade or business. The possibility of the grants made to the B.B.C. being classified as a subsidy could, it is submitted, have received more consideration in the Court of Appeal than it appeared to receive; but the decision makes it clear that the fact that the contributions are made by the Crown to a taxpayer carrying on an enterprise of a public nature is not of itself a bar to mutuality.

IV BASIS OF MUTUALITY

In considering the relevance of *B.B.C.* v. *Johns* to the principle of mutuality, no attempt has been made to formulate the principle: rather, some of its aspects only have been noted.[32] The question remains, what is its basis? The three possible bases to be considered might be termed the principles of (a) no profit; (b) no income; and (c) no trade.

At first the authorities seemed to be based on the simple proposition that a person cannot make a profit out of himself.[33] Thus in *re Glasgow Corporation Waterworks* Lord Deas said:

If there are any profits made here I think it is quite clear they must

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[28] *Ostime* v. *Pontypridd and Rhondda Joint Water Board* 28 T.C. 261 at 278 *per* Viscount Simon.

[29] 29 T.C. 643.

[30] *Ibid.* at 670 *per* Lord Macmillan.

[31] *Supra* n. 7.

[32] It will be apparent that the term "mutuality" is being abused when it is used in the present context, but it is a phrase which appears often in the reports. It can only be said, with Rowlatt, J. in *Municipal Mutual Insurance Ltd.* v. *Hills* 16 T.C. 430 at 438, when we have eventually found the basis of exemption from tax, "If you like to call that 'mutuality', well, it is a convenient word".

[33] *New York Life Insurance Co.* v. *Styles* 2 T.C. 460 at 484 *per* Lord Macnaghten; *Bohemians Club* v. *Act. Fed. Commr. of Taxn.* (1918) 24 C.L.R. 334; *Sharkey* v. *Wernher* 36 T.C. 275 at 303 *per* Lord Radcliffe; G. S. A. Wheatcroft, 1 *British Tax Encyclopaedia* para. 417.

> be profits made by the ratepayers because there are not two parties—the corporation on the one hand and the ratepayers on the other.[34]

Such a view, questionable where a separate municipal corporation was involved, became even more questionable when the principle was applied to limited companies carrying on the business of insurance, and seems to have been rejected in *English and Scottish Joint Cooperation Wholesale Society Ltd.* v. *Commissioner of Agricultural Income Tax, Assam.*[35] In *Sharkey* v. *Wernher* Viscount Simonds said[36] that "the true proposition is not that a man cannot make a profit out of himself but that he cannot trade with himself", and that even the "true proposition" did not hold if the taxpayer was regarded as having a dual capacity.[37]

The second possible basis, here termed the "no income" principle, is that any surplus remains the property of the contributors, who receive a benefit when it is carried forward either for application against future expenses or for eventual return to the contributors.[38] But this basis seems highly questionable when it is recalled that:

(i) there need in fact be no periodical return of surplus[39] or any return at all;[40]

(ii) the identity between those who contribute and those who receive on a distribution is only a class identity;[41]

(iii) even where the identity is an individual identity, the stress lies upon entitlement to benefit rather than enjoyment of the benefit.

In the club cases, provided all the members have the right to use the club amenities, it seems not to matter that not all members in fact use the amenities and obtain the benefit of their subscriptions.[42] *B.B.C.* v. *Johns* seems to have removed the last restraint on the arbitrary operation of this principle by suggesting that the surplus need not even be held available for the benefit of contributors.

It is the second basis that Willmer, L.J., and Danckwerts, L.J. at one point, seem to be adopting in *B.B.C.* v. *Johns.*[43] Insofar as they do adopt it, the objections listed above apply. But the approach taken by Diplock, L.J. suggests the third possible basis: that funds are not assessable to income tax unless they arise from trading, and that where money is contributed in circumstances which require that any surplus be returnable to the contributors there is no trading. A passage from his judgment is set out at length:

> I think that this question turns on the ordinary meaning of the words "annual profits or gains". I do not think that it is illuminated by elaboration or that the so-called "mutuality" cases and "rating" cases which were cited have any relevance except as examples of other circumstances in which the Court has applied the ordinary meaning of "annual profits or gains" to a surplus which happens to be in the hands of a taxpayer to be carried forward into a new accounting year. My conclusion in this case would be the same if the source of the B.B.C.'s funds was not aids

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[34] 1 T.C. 28 at 50.
[35] (1948) A.C. 405.
[36] 36 T.C. 275 at 296.
[37] *Ibid.* at 298.
[38] *Jones* v. *South-West Lancashire Coal Owners Association* 11 T.C. 790 at 830; *Municipal Mutual Insurance Ltd.* v. *Hills* 16 T.C. 430 at 448 *per* Lord Macmillan; *I.R.C.* v. *Forth Conservancy Board (No. 2)* 16 T.C. 103 at 117 *per* Lord Buckmaster; *New York Life Insurance Co.* v. *Styles* 2 T.C. 460 at 469-71, 482; *Bohemians Club* v. *Act. Fed. Commr. of Taxn.* (1918) 24 C.L.R. 334.
[39] *Supra* n. 23.
[40] *I.R.C.* v. *Eccentric Club Ltd.* 12 T.C. 657; and see *supra* n. 26.
[41] *Supra* n. 24.
[42] *National Association of Local Government Officers* v. *Watkins* 18 T.C. 499; *Adelaide Racing Club Inc.* v. *Fed. Commr. of Taxn.* (1964) 38 A.L.J.R. 204.
[43] 41 T.C. 471 at 501-2, 508-9. See in particular the reference by Willmer, L.J. to *Commissioners of Inland Revenue* v. *Forth Conservancy Board* 16 T.C. 103 at 117.

or supplies appropriated by parliament for that purpose; that is, the National Exchequer.[44]

This third basis does avoid the objections to the two alternative bases previously considered, and it can be said that there is "no profit" or "no income" simply because in the circumstances there is "no trade". But it is submitted that it is just as unsatisfactory. In the first place, who is to be considered as the other trading party? The trade must be with the contributors, but is it not an appropriate use of language to say that the members of the National Association of Local Government Officers or of the Adelaide Racing Club Inc. who bought refreshments at their club were trading with it?[45] Or to say that the members of the general public who, in a common commercial transaction, took a fire insurance policy with Municipal Mutual Insurance Ltd., were trading with the company?[46] Or to say that the Glasgow ratepayers were trading with the municipal corporation?[47] With respect to Diplock, L.J., even if the issue is phrased in terms of the normal meaning of "annual profits or gains", the normal meaning would, so far as the element of trading is involved, encompass the surpluses just mentioned.

Authority also stands against the third basis. In *I.R.C.* v. *The Cornish Mutual Assurance Co. Ltd.*[48] a company carrying on a mutual fire insurance business was assessed to Corporations Profit Tax in respect to its surplus on transactions with members. It was accepted that the surplus arose from mutual transactions, but s. 53(2)(h) of the Finance Act, 1920,[49] brought the surplus into tax provided the company was "carrying on any trade or business" (s. 52(2)(a) Finance Act, 1920). Viscount Cave, L.C. gave the leading speech in the House of Lords, Lords Atkinson, Shaw of Dunfermline, Sumner and Darling merely agreeing, and said:

> Is the Company carrying on trade or business? I have no doubt that it conducts the business of fire insurance. It is true that it only carries on that business with its own members: but as every person who effects a policy with the company ipso facto becomes a member the restriction does not prevent the transaction of the company from being a business transaction.[50]

At a later point the Lord Chancellor, referring to the speech of Lord Watson in *New York Life Insurance Co.* v. *Styles*,[51] said:

> I cannot believe that he intended to decide that a company of this kind, simply because it was a mutual company, did not carry on any business at all. At all events, I feel myself no doubt upon the question.[52]

Perhaps this decision is to be restricted to cases where a separate corporate entity exists, but even this prevents it being said that absence of trading is the common feature underlying the mutuality and rating cases.

To recapitulate, it is suggested that the mutuality principle is based upon neither mutuality as ordinarily understood, nor inability to profit from one's self, nor absence of trading, nor individual identity between those who contribute

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[44] *Id.* at 514, and at 513 the emphasis on the fact that the B.B.C. is not entitled to receive any payment from any person.

[45] *National Association of Local Government Officers* v. *Watkins* 18 T.C. 499; *Adelaide Racing Club Inc.* v. *Fed. Commr. of Taxn.* (1964) 38 A.L.J.R. 204; and see *British Legion* v. *I.R.C.* 35 T.C. 509 where the proceeds of public dances accumulated with a view to providing a hall for ex-servicemen were held to arise from a trade carried on by the taxpayer. As the Lord President observed (at 514), if a taxpayer is conducting business on commercial principles, "it matters not from what motives he acts nor to what purpose he devotes the profits, if any".

[46] *Municipal Mutual Insurance Ltd.* v. *Hills* 16 T.C. 430.

[47] *Re Glasgow Corporation Waterworks* 1 T.C. 28.

[48] 12 T.C. 841, (1926) A.C. 281.

[49] 10 & 11 Geo. 5 c. 18.

[50] 12 T.C. 841 at 867.

[51] 2 T.C. 460.

[52] 12 T.C. 841 at 867.

funds and those who benefit from the application of the funds nor individual identity between those who contribute funds and those entitled on distribution of the surplus. The remaining possibility, class identity of contributors and those entitled to distribution of surplus is, it is submitted, an inadequate explanation of the cases and unsatisfactory in point of principle. No formulation of the mutuality principle, nor any statement of its minimal requirements, can be made without reservations.[53]

V APPORTIONMENT

The Court of Appeal considered that the income coming to the B.B.C. from selling its publications and from its investments should be severed from the surplus of Crown moneys, and that it was no objection that this involved a calculation "of some difficulty and complexity".[54] Both Willmer, L.J. and Danckwerts, L.J. referred to *Carlisle and Silloth Golf Club.* v. *Smith*,[55] but neither gave any indication of how the apportionment of overheads should be effected. In *Carlisle and Silloth Golf Club* v. *Smith* an unincorporated golf club admitted non-members to play on the links on payment of green fees. The Crown assessed the proportionate part of the yearly surplus that was attributable to profits arising from visitors' green fees, and in making allowance for maintenance of the course and club-house, took from the total visitors' fees for the year such proportion of the total expenditure applicable to both members and visitors as the fees bore to the total income of the club; that is:

$$\frac{\text{Income from visitors}}{\text{Total income}} \times \text{Apportionable surplus}$$

Hamilton, J., with whom the Court of Appeal agreed, said that this was not a proper dissection of the overhead charges for the purpose of distributing to the earning of green fees that proportion of the club's outlay which truly went to the earning of that income. It was merely a rule of thumb, and the matter had to go back to ascertain the real profits.

In *B.B.C.* v. *Johns* this case was not specifically endorsed in respect to the method of apportionment. In *Adelaide Racing Club Inc.* v. *F.C. of T.*[56] Owen, J. also referred to the case, and gave an apparently conflicting decision on this point. The facts were basically identical: the Club received income from members, which was not assessable due to the mutuality principle, and income from non-members, which was assessable. An amount of £148,631 was regarded as having been expended partly for the purpose of producing assessable income and partly for the purpose of producing non-assessable income, and to apportion this amount and ascertain the figure allowable as a deduction from assessable income the Commissioner adopted (in effect) the formula:

$$\frac{\text{Income from non-members}}{\text{Total income}} \times \text{Apportionable expenditure}$$

Owen, J. noted that the alternative bases of apportionment suggested by the Club were all open to criticism and produced varying results. He said:

> The Commissioner made what he regarded as a just apportionment of the club's expenditure, allocating against assessable and non-assessable

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[53] F.E. La Brie, *The Meaning of Income in the Law of Income Tax* (Toronto, 1953) p. 126 explains mutuality simply as "an application of the general doctrine that income must be beneficially received", and says that "the so-called 'mutual principle' involves nothing beyond an identity of interest between the membership and the organization". The alleged simplicity of this view does not adequately account for the cases.

[54] 41 T.C. 471 at 500 *per* Willmer, L.J.

[55] 6 T.C. 48 and 198.

[56] (1964) 38 A.L.J.R. 204.

> income respectively the proportions of that expenditure that seemed right and I am not satisfied that the course he followed was wrong or that the resulting assessment . . . was excessive.[57]

That is, for practical reasons, Owen, J. accepted a rule of thumb so long as it did not seem unjust; the Commissioner is given a freedom of estimation his United Kingdom counterpart does not have.

VI MUTUALITY AND THE COMMONWEALTH INCOME TAX ASSESSMENT ACT

In Australia the mutuality principle has regularly been accepted (if little applied) before the Boards of Review, but there is a comparative lack of judicial authority since *Bohemians Club* v. *Acting F.C. of T.*[58] This makes the comparatively recent decisions in *Adelaide Racing Club Inc.* v. *F.C. of T.*[59] and *Revesby Credit Union Coop. Ltd.* v. *F.C. of T.*[60] of interest. The former case simply assumes the applicability of the principle to contributions by members of a club, but in the latter case McTiernan, J. said that the principle of mutuality was well settled and stated it thus:

> When a number of people contribute to a fund created and controlled by them for a common purpose any surplus paid to the contributors after the use of the fund for the common purpose is not income but is to be regarded as a mere repayment of the contributors' own money (*Bohemians Club* v. *Acting Federal Commissioner of Taxation* (1918) 24 C.L.R. 334). . . . What is required is that the fund must have been created for the common purpose and owned or controlled wholly by the contributors.[61]

As the contributors to the fund were the borrowers who paid interest, while the beneficiaries entitled to dividends were all members, some of whom were not eligible as borrowers, his Honour decided that there was not sufficient identity between the contributors and the beneficiaries entitled to distribution of the surplus; alternatively, the fact that not all members entitled to borrow did actually borrow funds and therefore contribute interest would be a disentitling factor.[62] Although the point may not be of great importance, as McTiernan, J. held that the credit union was a "cooperative company" for the purpose of the Income Tax Assessment Act as it fell within s. 117(d) of that Act, could a sufficient identity be created by arranging for all members of the credit union to pay an annual subscription?

It will be noted that McTiernan, J. rested the mutuality principle on the second ("no income") basis discussed above; he did not rest it on lack of trading or the ordinary meaning of the word "income". The notion fundamental to income tax law in Australia is "income", not "annual profits or gains", except in special circumstances.[63] May it be argued that a body may have "income" even though not trading, where it might not make a "profit or gain"? If funds actually come into the hands of a mutual insurance company, club, or even the A.B.C., it is not an abuse of language to say that income has been received. In *Sharkey* v. *Wernher* Lord Radcliffe said:

> I doubt very much whether the result of those decisions (*New York Life Insurance Co.* v. *Styles* and *re Glasgow Corporation Waterworks*) could have been what it was if the Income Tax Statute had declared that the

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[57] *Id.* at 207.
[58] (1918) 24 C.L.R. 334.
[59] (1964) 38 A.L.J.R. 204.
[60] (1964) 38 A.L.J.R. 358.
[61] *Id.* at 361. Note that his Honour was referring in terms to taxability of the contributor, not the fund.
[62] *Id.* at 361: "First of all members are current borrowers, . . ."; *sic*, but *quaere* "First of all not all members are current borrowers, . . ."
[63] See Income Tax Assessment Act, 1936, as amended, s. 25; *cf.* s. 26(a).

> operations in question were to be regarded as a trade and, as such, a source of taxable profit.[64]

The House was there concerned with Case I of the Act, "tax in respect of any trade . . ."[65] and for this reason, apparently, commentators consider the decision not applicable in Australia and New Zealand.[66]

In the result, therefore, if the indications in *B.B.C.* v. *Johns* that the basis of the mutuality principle is absence of trading are later authoritatively established, the availability of this principle in Australia may have to be reconsidered. If, however, the second basis discussed above is reaffirmed, then as it depends on facts, not concepts, the mutuality principle, uncertain and uneven in operation as it is, will remain available.

R. D. GILES, B.A., Case Editor — Fourth Year Student.

OPPRESSIVE CONDUCT IN THE AFFAIRS OF COMPANIES

RE BROADCASTING STATION 2GB PTY. LTD.[1]
RE ASSOCIATED TOOL INDUSTRIES LTD.[2]

INTRODUCTION

The early English Acts[3] providing for separate legal identity and limited liability introduced new legal concepts which set the company on its feet as an instrument for commercial expansion. Over the years, however, the basic role of the average shareholder in a limited liability company has changed from that of co-adventurer and active participant in the company's fortunes, to that of passive supplier of capital with a relatively small shareholding. This has aggravated the perennial problem, still a long way from being solved, of preventing or containing oppressive conduct by controlling factions of shareholders or directors.

It is probably no exaggeration to say that until recent years both legislative and judicial policy was largely that of non-intervention in the affairs of companies. Such intervention as did occur was rather hesitant and reluctant and the principles which have emerged from the application and adaptation of traditional legal rules can fairly be described as hazy, ill-defined and unsatisfactory. Continuing abuses have compelled the recent introduction of novel statutory remedies which have proved to be most beneficial. They do not, however, extend to all situations where the remedies which they provide might be thought to be appropriate and in some circumstances it may still be necessary to seek relief, if it be available, under the general law. It is not proposed to deal in detail here with the principles developed by the general law to regulate oppressive conduct. It will be observed, however, that those principles are also relevant to the application of the statutory remedies.[4]

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[64] 36 T.C. 275 at 303.
[65] *Supra* n. 2.
[66] J. A. L. Gunn, *Commonwealth Income Tax Law and Practice* (7 ed. 1963) para. 1061; N. E. Challoner and J. M. Greenwood, *Income Tax Law and Practice* (2 ed. 1962) para. 367; and H. A. Cunningham, *Taxation Laws of New Zealand* (5 ed. 1963) para. 563.
[1] (1964-5) N.S.W.R. 1648.
[2] (1964) A.L.R. 73.
[3] Trading Companies Act, 1834, 4 & 5 Wm. 4 c. 94; Chartered Companies Act, 1837, 7 Wm. 4 & 1 Vict. c. 73; Joint Stock Companies Act, 1844, 7 & 8 Vict. c. 110; Companies Clauses Consolidation Act, 1845, 8 & 9 Vict. c. 16; Limited Liability Act, 1855, 18 & 19 Vict. c. 133.
[4] See, e.g., the *2GB Case supra* n. 1 and *infra.*